FAS WORLDWIDE

United States Department of Agriculture
Foreign Agricultural Service

July 2006

An online review of Foreign Agricultural Service initiatives and services

Market and Trade Data

China's Food Service Sector Continues Sustained Growth

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One of the earliest sectors opened to foreign investment, in the 1980s, China's HRI (hotel, restaurant, and institutional) sector developed slowly before taking off in the early 1990s. Supported by rapid, steady economic growth across several industries, and rising per capita incomes among urbanites in traditional and emerging city markets, China's HRI sector has shown double-digit expansion in each of the last 15 years. HRI revenues totaled $109.53 billion in calendar 2005, 16.8 percent over the previous year, accounting for 13.9 percent of China's total consumption sales revenue; HRI revenues are projected to reach a new high of $127.86 billion in 2006.

Imported foods typically cost much more than domestic items, and only a small percentage of China's 1.3 billion people can afford to eat in restaurants that use imports. Per capita income for China's 800 million rural residents was only $308 in 2003. Urban income was $1,027 per capita, but that still leaves little for high-end meals.

Consumers with the highest disposable incomes tend to be concentrated in Shanghai and Beijing, and in cities of the Pearl River delta. In 2004, Shanghai's per capita spending on dining out was three times the national average; levels in Tianjin, Beijing, and Guangdong Province were two times the average. However, Guangzhou, the capital of Guangdong, was the undisputed leader at seven times the national average, $515.30 per capita spent on dining out.

Prosperity is spreading as the economy develops, bringing new tastes and higher-end dining to a much larger segment of the population. Cities all across the country such as Qingdao, Dalian, Xiamen, Wuhan, and Changsha are taking part in China's economic expansion.

The top tier of China's urban population now earns a per capita income of $5,000 per year. These consumers, having the desire and the means to eat out regularly in good restaurants, tend to embrace opportunities to be educated about sophisticated tastes and foreign culinary experiences. The top 15 percent of city dwellers in China can now afford imported foods, a market of more than 150 million people at present, and one that is growing exponentially as incomes rise.

The market mantra: the Chinese market needs to be educated from A to Z on most imports.

The Importance of Dining Out

Social, business, and family occasions are celebrated with meals at which preparation, quality, and ingredients are often topics of passionate discussion. Chinese families like to celebrate holidays and personal milestones by going out to eat at restaurants; most urban Chinese live in small apartments with limited kitchens. Government and business meals comprise a huge and growing market. With the importance of appearances, hosts spare little expense, often providing high-end imported or domestic products.

Western-style fast-food restaurants often run birthday promotions for children, while hotel restaurants target families. Restaurateurs are paying more attention to atmosphere, venue, and décor to attract high-end business.

There has been a large influx of people from Taiwan, Hong Kong, Australia, Europe, Japan, South Korea, and the United States. In some cities, expatriates are numerous enough to create markets for foreign foods, and often introduce Chinese friends and associates to new tastes and preparations. Western cuisines increasingly figure prominently in the HRI mix. Market insiders also cite curiosity and a growing taste for Western food as key drivers for imports.

China's growing middle class has become more aware of health and hygiene issues.

Episodes involving SARS, avian influenza, and problems with adulterated and unsanitary foods have indirectly helped imported foods, because they have spurred consumers to patronize larger, cleaner restaurants serving higher-quality, more hygienic, healthier foods, many of which are imports.

The Big Picture

Currently only slightly more than 20 percent of hotels in China are profitable. Most of them are joint ventures or internationally branded and managed; two-thirds of China's 200 five-star hotels are foreign. But with continuing economic development, a rapidly growing tourism industry, the 2008 Summer Olympics, and the 2010 Shanghai World Expo, China's hotel industry is embracing new market opportunities.

China has more than 10,000 star-rated hotels, with business hotels currently experiencing a boom. Vocational training is being strengthened to meet hotels' growing demand for food service workers. Most multinational hotel groups are looking into the use of value-added products, although executive chefs and managers continue to be driven mostly by price in purchasing decisions. Imports traditionally make up 30-50 percent in value of foods purchased by internationally managed five-star hotels, but this can vary greatly from city to city.

Most Chinese hotel chains are still state-owned, but many are being forced to modernize management and develop efficient and profitable food service. Hotels in predominantly tourist destinations, such as Beijing, Suzhou, Hangzhou, and Xian, are more likely to have larger imported food budgets than typically business destinations like Dalian and Qingdao. Japanese and Korean cuisine in northern cities often exerts significant influence on local tastes and food imports.

The high-end restaurant segment is growing exponentially, albeit from a very small base. Restaurants specializing in non-Chinese foods have tripled since 2000 in Shanghai, from 130 to 380, and nearly doubled in Beijing, from 95 to 179. The restaurant segment is more difficult to define and serve than the five-star hotel segment, given lower import volumes and expenditures ranging anywhere from $7,500 to $30,000 per month per restaurant.

Perhaps the most encouraging development is that more Chinese-style restaurants are using imports. Fusion and modern Chinese cuisines are helping to create a new up-market tier, with higher sales and profit margins that justify import use.

Fast Food Coming on Fast

Fast-food chains have also experienced rapid growth. Yum Brands and McDonald's are by far the largest fast-food chains in China. Yum has almost tripled its outlets over the past four years, from 650 to 1,908. McDonald's has boosted its presence to over 666 outlets and plans to open up to 100 new outlets annually, beginning in 2006. There are also 1,758 KFCs, 150 Pizza Huts, and several Taco Bells and A&Ws.

After 15 years of successful business by rivals KFC and McDonald's, Burger King opened its first directly managed outlet in Shanghai in June 2005; the company plans to develop the East China market, then expand north to Beijing. Starbucks operates 165 shops in 18 cities through franchisees, although it plans to shift to direct management of what the company predicts will be its largest market. Taiwan's Dicos is another large and important player. Yonho, a traditional Chinese fast-food chain that recently acquired Taiwan brand 98 Pizza, plans to expand outlets in the Yangtze River delta beginning in 2006.

These companies import 5-10 percent of their foods. Often their suppliers are multinational manufacturers that have established their own standalone supply chains.

Difficulty in the standardization of ingredients and preparation, without losing the flavor and taste of higher-calorie ingredients, is a serious impediment to Chinese fast-food development. The ambiance of Western outlets is what Chinese fast-food restaurants lack, and customers want most.

Many ethnic fast-food chains offer Mongolian hot pot, dim sum, Beijing- or Shanghai-style dumplings, and Cantonese and Sichuan foods in new locations. Successful chains are quickly imitated.

Institutional Segment Heating Up

In 2004, as much as 40 percent of HRI expenditures in China came from institutional food service. Institutional clients include cafeterias at schools, government bureaus, hospitals, and businesses, and transportation outlets like airlines. Individual meal budgets are usually low, so imported ingredients seldom make it into the mix.

In the past, most institutions were state-owned and ran their own cafeterias, but now services are outsourced. Meal services for office and factory workers, travelers, and students are contributing to HRI growth. Successful players such as Shanghai's Fu Ji Food and Catering Service doubled revenues in 2004. International companies like Eurest, Sodexho, and Gate Gourmet have joined the market, and others are reportedly on the way.

China's catering industry is in its infancy, yet over the last decade momentum has been building, first in the major urban areas of Beijing, Shanghai, and Guangzhou, and more recently in other cities with high business and tourist traffic. A rough estimate puts the number of Chinese catering businesses near 1 million; in Shanghai, catering companies with more than $10 million in annual revenues continue to emerge. For airline catering, which generates more than $240 million annually, imported food content ranges up to 50 percent on international flights, but is much lower on domestic flights.

Limitations of existing regulations, standards, and transparency hinder development and entry of foreign brands into this segment. However, recent catering guidelines that attempt to streamline procedures and tighten sanitary and health standards may help to surmount these difficulties.

Caveat Vendor: Trade Advantages and Pitfalls

As in any country, U.S. products enjoy some advantages and face some challenges in China's HRI market.

On the plus side, the popularity of U.S. culture extends to foods, and U.S. fast food leads in introducing Western products in China. Strong U.S. brands stand out in an environment low in brands. The United States is recognized as a leader in food service techniques, technology, and management. Tariff cuts mandated by the WTO (World Trade Organization) specifically benefit major U.S. products such as meats, corn, soybeans, grains, and cooking oil. China's climbing demand for prepared foods caters to a U.S. strong point.

Among the challenges, the Chinese cold chain remains unreliable outside the major urban areas of Beijing, Shanghai, and Guangzhou. Even in major metropolitan areas, inconsistent supplies persist. Long lag times separate product orders and deliveries. U.S. suppliers also face high trans-Pacific shipping costs.

The Chinese market for imported food is intensely competitive, with suppliers around the world battling for market share. Australia, New Zealand, South Africa, and the European Union supply most products likely to compete directly with U.S. goods. European- and Australian-trained chefs, who tend to favor products from those areas, outnumber U.S.-trained chefs in high-end establishments. There is a general lack of knowledge about proper handling and use of imported products in China's HRI sector. As China's food manufacturing develops, domestic products will offer increasingly stiff competition to imports.

Poor protection of intellectual property and widespread imitation of successful brands abound, and fake products can damage brand image. Ideally, a supplier should take steps to protect intellectual property rights before exploring the Chinese market. It's advisable to register and protect trademarks in both the English and Chinese languages. In 2005, China's State Administration for Industry and Commerce announced a campaign to improve enforcement of agricultural-related trademarks beginning in December 2005.

Even if a supplier's goods are not being sold in China, protecting intellectual property rights can help prevent fake goods produced there from being exported to other markets. Chinese customs provides an online recording service that is usually a prerequisite for customs detention of outbound goods suspected of infringing property rights.

Help With Protecting Intellectual Property

The U.S. Embassy in Beijing has a Web-based toolkit to help U.S. manufacturers and traders protect intellectual property rights, and to help China develop a system more similar to that of the United States: http://www.usembassy-china.org.cn/ipr

Protectionist impulses and abrupt policy changes often raise nontariff barriers. Clearing customs has become more transparent as standard protocols for individual products evolve port by port. But arbitrary treatment and policy changes can still impede or even block shipments unexpectedly, and importers complain that inspectors will block shipments even for slight variations in paperwork.

The Indispensable Good Distributor

The single most important requirement for entering China's HRI market is to partner with a good distributor. Chinese business is famously a "relationship culture," in large part because the rule of law is weak, and contracts are difficult to enforce. Face-to-face contact is essential to beginning and maintaining a relationship with a distributor.

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A good distributor should be able to handle customs, quarantine, and any licensing procedures. Some distributors do their own paperwork; others use import agents. Market entails so many rules and so much red tape that few suppliers or end-users — even Chinese state-owned companies — try to do it on their own.

It is crucial that the importer or distributor pay the U.S. supplier in hard currency, or the supplier will have trouble collecting payment. The renminbi (or yuan) is not a fully convertible currency; moreover, companies must have special licenses to change yuan into dollars. Yuan-dollar exchange rates fluctuate widely, so it is important to ensure that payments and costs are stated and payable in currencies agreed upon by both buyer and seller.

China has been liberalizing its distribution industry under WTO rules, and a small group of foreign-managed companies has emerged in ports and free trade zones that offer customs clearance, foreign exchange conversion, bonded warehousing, and shipment. But they do not specialize in the food business, so suppliers and exporters still need distributors or sales agents to handle sales, promotion, and bureaucratic hassles, such as licenses, labels, and payment.

A nascent distribution development is fourth-party logistics, or logistics information management systems, which HRI leaders are starting to embrace. Beijing's Yoshinoya Fast Food Co. Ltd. is using the system to streamline purchasing and distribution, and integrate accounting with front-line outlets. The system substantially decreases the time to respond to the market and inventory losses.

All along the value chain, experienced suppliers, distributors, and buyers stress that penetrating the Chinese market is rewarding but hard work. Selling and distributing a product requires face-to-face contact, a special effort to educate the entire value chain, and attention to distribution details. Even good distributors in China often lack marketing experience, and it can be difficult to get them to focus on promoting a particular product among hundreds or even thousands that they may carry. Distributors won't do all the work, but more and more are willing to help suppliers make a product successful. ■

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